

**Letter Report: Improvements at the
Lockbox Bank in Atlanta Are Needed
to Better Protect Taxpayer Payments
and Minimize Processing Costs**

February 2001

Reference Number: 2001-40-048

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

February 26, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in black ink, reading "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - Improvements at the Lockbox Bank in
Atlanta Are Needed to Better Protect Taxpayer Payments and
Minimize Processing Costs

This letter report presents the results of our review of the lockbox program in an Atlanta bank. The overall objective was to determine whether controls over the lockbox program provided reasonable assurance that taxpayer payments were processed in accordance with established guidelines. In summary, we found that the lockbox bank timely deposited all the taxpayer payments we reviewed. However, opportunities exist to improve the lockbox program in the areas of bank security and tax return sorting.

We recommended that the Commissioner, Wage and Investment Division, ensure that all required security measures are implemented and enforced and that the lockbox bank correctly sorts tax returns.

Management agreed to the recommendations we presented. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

Objective and Scope

The objective was to determine whether controls provided reasonable assurance that taxpayer payments were processed within established guidelines.

The overall objective of this review was to determine whether controls over the lockbox program in an Atlanta bank provided reasonable assurance that taxpayer payments were processed in accordance with established guidelines. To achieve our objective, we:

- Reviewed two judgmental samples totaling 337 remittances received by the bank during April and May 2000. We reviewed one sample of 150 remittances to determine whether they were timely deposited and accurately posted to taxpayers' accounts. We reviewed another sample of 187 remittances to determine if they were properly over stamped with "United States Treasury" as required.
- Reviewed a judgmental sample of 228 tax returns received by the bank during May 2000 to determine whether they were sorted in accordance with established guidelines.
- Held discussions with local lockbox bank (Bank of America) and Internal Revenue Service (IRS) officials and reviewed procedures and reports to determine whether the bank correctly performed other required services, such as shipping tax returns and monitoring bank activities.
- Visited the local lockbox bank on May 25, 2000, to observe and evaluate the controls over the physical security of taxpayer payments, tax returns, and other taxpayer data.

Audit work was performed at the Atlanta Submission Processing Center (ATSPC) and the Atlanta lockbox bank from May 2000 through June 2000. The audit was performed in accordance with *Government Auditing Standards*.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

The lockbox bank deposits tax payments and performs other services, which allows the IRS to process returns quicker.

The IRS lockbox program consists of commercial banks that have contracted with the Financial Management Service (FMS), another government agency, to process tax payments. This program was designed to accelerate the deposit of tax payments by having taxpayers send their payments to commercial banks rather than to the IRS. According to the IRS, from January through April 2000 this bank processed over 3.4 million tax payments totaling over \$17 billion. The bank also received over 1 million tax returns.

The Statement of Work (SOW) and Lockbox Processing Guidelines are agreements between the FMS and the bank detailing the specific services that the bank will perform for the IRS. These services include tasks that the IRS would otherwise have to do, such as ensuring checks are made payable to “Internal Revenue Service,” “IRS,” or the “United States Treasury,” providing security over the remittances and taxpayer data, and creating computer tapes of payment transactions that are sent to the IRS. The bank also receives, sorts, and ships tax returns to the IRS.

The IRS is responsible for providing oversight of bank activities to ensure the lockbox banks adhere to the procedures in the SOW.

Results

The IRS provided adequate oversight of bank activities by conducting required reviews such as on-site visitations and monthly performance reviews.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

The lockbox bank timely deposited all of the tax payments we reviewed.

The bank timely deposited all 150 tax payments that we reviewed.¹ Ninety-nine percent of those payments also posted correctly to taxpayers' accounts.² While these are significant accomplishments, opportunities exist to improve the Atlanta lockbox program in the following areas:

- Bank security (to further minimize the risk of theft and unauthorized actions by bank personnel).
- Accurate sorting of tax returns (to minimize processing costs and improve customer service).

Bank Security Needed Improvement

The bank was contractually required to provide adequate security, equipment, and facilities to safeguard all taxpayer payments and data that it received. During our visit to the bank, we found that the bank complied with some of the security requirements. For example:

- Security cameras were strategically positioned to monitor the bank entrance, processing areas, employee locker rooms, and loading docks.
- Police background checks were conducted for all 25 employees reviewed.
- Unscheduled desk checks of employees were conducted every week as required.

¹ Tax payments must be deposited within 24 hours of receipt during non-peak periods and peak periods other than April for scannable documents, within 48 hours of receipt during peak periods other than April for non-scannable documents, and by April 30, 2000, during April.

² The remaining 1 percent involved a payment that was processed with an incorrect Social Security Number, but was subsequently corrected and posted within 18 days.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

Checks totaling over \$5.6 million were not deposited timely.

Our visit to the bank identified the following security risks:

- On May 8, 2000, a bank manager conducting an unannounced desk check found 14 checks from 12 taxpayers totaling over \$5.6 million that had not been deposited. The checks were all dated around April 15, 2000, and were with requests for extensions to file tax returns.

The SOW requires that checks over \$50,000 be deposited immediately. A local procedure requires that managers walk these checks through the deposit process. Instead, the checks were put in a filing cabinet with other checks and apparently fell beneath the drawer, where they remained undetected. The government lost approximately 3 weeks of interest (approximately \$16,000³) on these funds, and the checks were vulnerable to theft.

Terminated employees continued to have access to the lockbox bank computer system.

- Our analysis of 25 terminated bank employees showed they had active passwords to the lockbox bank computer system used to process taxpayer information for extended periods of time after termination. Bank personnel indicated that it was too time consuming to delete employees from the computer system between peak periods.
- We observed two individuals in restricted areas of the bank without an identification badge. Neither security personnel nor bank managers challenged these employees.
- We identified 7 of 187 checks, totaling \$13,150, that were not made payable to or stamped with "United States Treasury." Although this is a low error rate

³ We used the Current Value of Funds Rate of 5 percent as the interest rate that would be earned on money deposited into the Federal Reserve banks. We applied the 5 percent interest rate against the \$5.6 million for 21 days, resulting in approximately \$16,000 in lost interest revenue to the government $(.05 / 360 \text{ days}) \times 21 \text{ days} \times \$5.6 \text{ million} = \$16,333$.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

(4 percent), the risk of theft is increased when checks are not stamped as required. There were two thefts from the bank during Fiscal Year 2000. Both thefts involved money orders that were not stamped, one for \$250 and the other for \$700, and both are being prosecuted.

- We observed a bank manager giving a deposit to a bank courier who did not have proper identification. The bank manager stated that he/she knew the courier by sight. However, the individual's employment status with the courier service could have changed. We reported this incident to both the bank and IRS management, and the manager was subsequently reprimanded.

IRS employees did not sign for packages delivered from the lockbox bank.

We also determined that security weaknesses existed at the IRS when IRS employees did not sign for lockbox bank packages containing tax returns, unprocessed tax payments, and other IRS documents upon arrival at the ATSPC. The SOW requires the courier⁴ to obtain a signature from the IRS employee accepting the packages and add the time delivered to account for and verify the timeliness of the package. However, ATSPC personnel were not aware of this requirement.

The bank and ATSPC personnel have not implemented or enforced all existing security requirements. Inadequate security over personnel, tax returns, and tax payments can lead to embezzlements and/or unauthorized disclosure of taxpayer information. As stated previously, during the period January through April 2000, the bank processed over 3.4 million tax payments totaling over \$17 billion that were vulnerable to theft. The bank also handled over 1 million tax returns that were vulnerable to unauthorized use and disclosure of taxpayer information.

⁴ Lockbox banks contract with courier companies to deliver packages containing tax returns, unprocessed tax payments, and other IRS documents to IRS Submission Processing Centers.

**Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed
to Better Protect Taxpayer Payments and Minimize Processing Costs**

Recommendation

1. The Commissioner, Wage and Investment Division, should ensure that all required security measures are implemented and enforced.

Management's Response: The IRS responded that, "We directed all Lockbox Coordinators to complete their monthly reviews until implementation of the new Quality Review Process. The first phase of the Quality Review Process began on January 15, 2001. This phase includes a procedural and administrative review of lockbox processing from the time the lockbox site receives the mail to the time the lockbox site forwards the package to the SPC and the money is deposited.

"The second phase will focus on reviewing the process from the time the SPC receives the package to just before the transaction posts to the taxpayer's account. The National Deposit Accuracy Measure will then see if the deposit posted correctly to the taxpayer's account."

The Bank Did Not Correctly Sort All Tax Returns

The SOW and the Lockbox Processing Guidelines describe the criteria for sorting the various types of tax returns. For example, returns with tax payments are to be sorted separately from returns that do not have tax payments. From January through April 2000, this bank was paid \$842,000 to sort over 1 million tax returns.

Our review of a judgmental sample of 228 tax returns received at the ATSPC between May 24, and May 31, 2000, showed that 87 of the returns (38 percent) were sorted incorrectly.

Bank personnel stated that bank employees may not have understood the sorting requirements and may not have been adequately trained in this area. When returns are not properly sorted, the IRS must spend additional

*The lockbox bank did not
always sort tax returns
correctly.*

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

resources to correctly sort them, which could result in processing delays.

Recommendation

2. The Commissioner, Wage and Investment Division, should ensure that the bank correctly sorts tax returns.

Management's Response: The IRS responded that, "The Headquarters Lockbox staff will research the feasibility of having SPC employees who are knowledgeable in sorting returns train employees at the Lockbox sites prior to the April peak. The SPC Lockbox Coordinators and the Headquarters Lockbox staff will review the April Peak On-Site Review reports to determine the benefits of the training. If the return sort error rate remains high, they will convene a task force to reanalyze the return sort process and develop other initiatives for improvement."

Conclusion

The Atlanta lockbox bank timely deposited all of the reviewed tax payments. However, security at the bank should be improved. Also, additional emphasis should be placed on the quality of the tax returns sorted by the bank.

**Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed
to Better Protect Taxpayer Payments and Minimize Processing Costs**

Appendix I

Major Contributors to This Report

Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs)

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**Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed
to Better Protect Taxpayer Payments and Minimize Processing Costs**

Appendix II

Report Distribution List

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**Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed
to Better Protect Taxpayer Payments and Minimize Processing Costs**

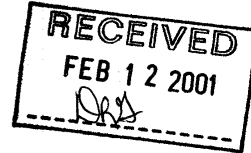
Appendix III

Management's Response to the Draft Report

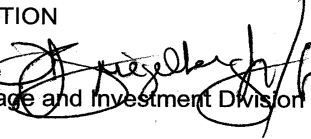


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

February 12, 2001



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION

FROM: John M. Dalrymple 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – "Improvements at the Lockbox
Bank in Atlanta Are Needed to Better Protect Taxpayer
Payments and Minimize Processing Costs" (Reference
No. 2000-40-057)

We appreciate the opportunity to respond to your draft report and recommendations for the Atlanta Lockbox Bank. The objective of your audit was to determine if IRS' controls over our Atlanta lockbox program provided reasonable assurance that the bank processed taxpayer payments in accordance with established guidelines. Your report concludes that:

- The lockbox bank deposited taxpayer payments within the required time frames.
- The system posted 99 percent of those payments correctly to taxpayers' accounts (with subsequent correction and posting of the remaining 1 percent).
- The lockbox bank has security cameras strategically positioned throughout its premises.
- The lockbox bank adheres to other contractual agreements by properly conducting background checks of its employees, and performing weekly unscheduled desk checks.
- The IRS provided adequate oversight of bank activities by conducting required reviews, such as on-site visitations and monthly performance reviews.

While we feel these facts are impressive, we are aware of areas needing improvement, especially in a setting where there is always a risk for potential loss. For this reason, not only do we agree with your recommendations, Wage and Investment Headquarters has already taken steps to address and measure the overall quality and oversight of our lockbox processing program.

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

2

Despite the shortcomings you identified, our lockbox processing program has been successful since its inception in 1985. We were pleased your report acknowledged the significant accomplishments we have realized by our continuing efforts to improve physical security and internal controls over taxpayer remittances.

Our comments on the specific recommendations in your report are as follows:

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should ensure that all required security measures are implemented and enforced.

ASSESSMENT OF CAUSE

In the past, Headquarters oversight of Lockbox and Submission Processing Center (SPC) Lockbox Coordinators needed improvement. The Headquarters Lockbox staff has already identified the deficiencies and is improving those processes.

CORRECTIVE ACTION

We directed all Lockbox Coordinators to complete their monthly reviews until implementation of the new Quality Review Process. The Headquarters Lockbox staff will track the receipt of the monthly reviews. The first phase of the Quality Review Process began on January 15, 2001. This phase includes a procedural and administrative review of lockbox processing from the time the lockbox site receives the mail to the time the lockbox site forwards the package to the SPC and the money is deposited.

The second phase will focus on reviewing the process from the time the SPC receives the package to just before the transaction posts to the taxpayer's account. The National Deposit Accuracy Measure will then see if the deposit posted correctly to the taxpayer's account. This new process will require the Lockbox Coordinators to be on-site during the four peak months (January, April, June, and September).

Additionally, Headquarters is now issuing "Lockbox Alerts" to quickly disseminate important information to Lockbox Banks and Coordinators.

PROPOSED IMPLEMENTATION DATE

Implemented: January 15, 2001

RESPONSIBLE MANAGEMENT OFFICIALS

Director, Submission Processing
Chief, Individual Master File Branch

Letter Report: Improvements at the Lockbox Bank in Atlanta Are Needed to Better Protect Taxpayer Payments and Minimize Processing Costs

3

CORRECTIVE ACTION MONITORING PLAN

We will update IRM 3.0.230, Lockbox Processing Procedures, to reflect the four mandatory on-site visits in 2001. The total redesign of the quality review process for Lockbox is near completion and will include new reporting requirements that the Headquarters Lockbox staff will track. This staff will roll up the review data and share it with management and the field.

RECOMMENDATION 2

The Commissioner, Wage and Investment Division should ensure that the bank correctly sorts tax returns.

ASSESSMENT OF CAUSE

Lockbox banks have high employee turnover rates, so new employees must consistently learn a new process.

CORRECTIVE ACTION

The Headquarters Lockbox staff will research the feasibility of having SPC employees who are knowledgeable in sorting returns train employees at the Lockbox sites prior to the April peak.

PROPOSED IMPLEMENTATION DATE

January 2002

RESPONSIBLE MANAGEMENT OFFICIALS

Director, Submission Processing
Chief, Individual Master File Branch

CORRECTIVE ACTION MONITORING PLAN

The SPC Lockbox Coordinators and the Headquarters Lockbox staff will review the April Peak On-Site Review reports to determine the benefits of the training. If the return sort error rate remains high, they will convene a task force to reanalyze the return sort process and develop other initiatives for improvement.

If members of your staff have questions, they may contact Annette Wuerfel, Program Analyst, at (513) 684-2208.